Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM 1980

No. 79-1371

GARY L. FOSTER, dba SNO-WHITE DRIVE IN, INC., GARY L. SUTHERS and DONALD HOYT HALL, aka DON HALL,
Petitioners,

v.

LAWRENCE T. LASAGNA, INC.,

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioners,

v.

LAWRENCE T. LASAGNA, INC.,

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Gary L. Foster, dba Sno-White Drive In, Inc., Gary L. Suthers and Donald Hoyt Hall, aka Don Hall, the petitioners herein, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals For the Ninth Circuit entered in the above-entitled case on December 7, 1979.

OPINIONS BELOW

The Opinion of the United States Court of Appeals For The Ninth Circuit, dated December 7, 1979, is

reported at 609 F2d 392 (9th Cir. 1979) and is printed in Appendix A hereto.

The Order of the District Court Judge, dated November 3, 1976, is printed in Appendix B hereto.

The Opinion of the Bankruptcy Judge, dated June 23, 1976, is printed in Appendix C hereto.

JURISDICTION

The judgment of said Court of Appeals was entered in said case on December 7, 1979. The jurisdiction of the Supreme Court is invoked pursuant to 28 USC § 1254(1) which provides:

> "Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:
>
> (1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;"

QUESTIONS PRESENTED

1. Should the Controlling Officers and Directors Who Misappropriate Assets From Their Corporation During Insolvency Thereby *Ipso Facto* Incur Personal Liability for Payment of All Claims of Creditors of the Corporation Even if Those Claims Greatly Exceed the Value of the Misappropriated Assets?

   A. Do the Controlling Officers and Directors of an Insolvent Corporation Owe a Fiduciary Duty to the Corporation's Creditors?

      (1) If Such a Fiduciary Duty Exists, is a Breach Thereof a "Fraud, Embezzlement, Misappropriation or Defalcation" within the

      Meaning of Section 17(a)(4) of the Bankruptcy Act?

   B. Are the Controlling Officers and Directors of an Insolvent Corporation Who Misappropriate its Assets Guilty Thereby of "Willful and Malicious Injuries" to the Accounts Receivable of the Corporation's Creditors Within the Meaning of Section 17(a)(8) of the Bankruptcy Act?

STATUTE INVOLVED

Section 17(a) of the Bankruptcy Act (11 USC § 35(a)) states (emphasis supplied to relevant portions):

> "(a) *A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as* (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision

thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this title: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; *(4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity;* (5) are for wages and commissions to the extent they are entitled to priority under subdivision (a) of section 104 of this title; (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment; (7) are for alimony due or to become due, or for maintenance of support of wife or child, or for seduction of an unmarried female or for breach of promise of marriage accompanied by seduction, or for criminal conversation; or *(8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision."*

Note: The above emphasized portions have been substantially re-enacted by the new Bankruptcy Act, which became effective October 1, 1979 (see 11 U.S.C. § 523(a)(4) and (a)(6) set forth in Appendix E).

STATEMENT OF THE CASE

On or about September 19, 1973 LAWRENCE T. LASAGNA, INC., a California corporation, (hereinafter "plaintiff") furnished the necessary equipment and operators to harvest tomatoes grown by PROGRESSIVE FARMING, INC., a California corporation (hereafter "Progressive"). As a result, Progressive became indebted to Plaintiff for $24,365.17. At that time and at all times relevant thereafter the petitioners Foster, Suthers and Hall were the only shareholders, directors and officers of Progressive.

On September 24, 1975, in an action entitled LAWRENCE T. LASAGNA, INC., vs. PROGRESSIVE FARMING, INC., *et al,* being Action No. 76375 of the Superior Court of the State of California, for the County of Tulare, judgment was entered by said Court, the Honorable Leonard M. Ginsburg, Judge, presiding, in favor of plaintiff and against Progressive and the three petitioners individually on the theory of *alter ego.*

Thereafter, petitioners filed their respective personal bankruptcy petitions with the United States District Court, Eastern District of California, as follows:

Bankrupt	*Date of Filing*	*Case No.*
Foster	9/3/75	F-75-1562-BKY
Hall	2/2/76	F-76-148-BKY
Suthers	4/5/76	F-76-581-BKY

Thereafter, Plaintiff filed three identical complaints in each of said bankruptcy cases pursuant to Sections 17(a)(4) and 17(a)(8) of the Bankruptcy Act seeking in each case an order denying to each Bankrupt a discharge as to plaintiff's debt solely. The complaint against Suthers, which is identical in form and content to the amended complaint filed against Foster and the complaint filed against Hall, is printed in Appendix D hereto, *infra*, page ——.

Petitioners' motions to dismiss for failure to state a claim were considered together upon the pleadings only and were granted by the Honorable Carl Eckhart Thompson, Bankruptcy Judge, whose Opinion, dated June 23, 1976, is printed in Appendix C hereto, *infra*, page ——.

Plaintiff appealed the orders of the Bankruptcy Judge granting the motions to dismiss to the U. S. District Court, Eastern District of California. The Honorable M. D. Crocker, District Court Judge, affirmed the decision of the Bankruptcy Judge, and his Order, dated November 3, 1976, is printed in Appendix B hereto, infra, page ——.

Plaintiff appealed the ruling of the District Court Judge to the United States Court of Appeals for the Ninth Circuit. Both sides filed their respective briefs and the matter was argued on July 16, 1979, at the Courthouse in San Francisco, California, before the Honorable Ben C. Duniway and Honorable Walter Ely, Circuit Judges, and the Honorable Edmund Port, Senior District Judge for the Northern District of New York, sitting by designation. Said Court issued its Opinion on December 7, 1979, and it is printed in Appendix A hereto, *infra*, page ——. Therein the Hon-

orable Court of Appeals by a unanimous decision held that a claim had been stated in the respective complaints against the petitioners pursuant to Section 17(a)(4) of the Bankruptcy Act, and by a 2-1 decision further held that a claim had been stated pursuant to Section 17(a)(8) of the Act.

REASONS FOR GRANTING WRIT

The United States Court of Appeals for the Ninth Circuit has decided important questions of federal law which have not been, but should be decided by the United States Supreme Court. With all due respect, the Court of Appeals has seriously erred in its interpretations of the applicability of Sections 17(a)(4) and 17(a)(8) of the Bankruptcy Act to the cases at hand. If that Court's decision is allowed to stand, irreparable and unjust harm will be imposed upon countless individuals whose corporate businesses fail and who must seek personal relief under the Bankruptcy Act. It is a fact of life that the owners of small corporations will generally misappropriate assets for family or personal needs on the eve of corporate bankruptcy or the ceasing of business. While such conduct by officers and directors is not to be condoned, neither should it be the basis for cruel and unusual punishment by the Bankruptcy Courts. However, the Court of Appeals decision, which overruled the well reasoned opinions of the Bankruptcy Judge and the District Court Judge, imposes upon erring officers and directors of insolvent corporations liabilities that are likely to be grossly disproportionate to the wrongdoing involved. It is submitted that the learned Bankruptcy Judge correctly analyzed the problem when in his opinion he reasoned:

"To hold Defendant's liability nondischargeable on the alter ego theory in this case or in any similar care could lead to an absurd result. For example, suppose Defendant's misappropriation in a given case is in the total sum of $10,000.00 and he owes 100 creditors $10,000.00 each? Should each of said 100 creditors have the right to have his debt declared nondischargeable so that Defendant would be subjected to a nondischargeable liability in the sum of $1,000,000.00? In the case at bar, Defendant's schedules list unsecured creditors in the amount of $2,487,866.56 (including contingent claims); should each of these creditors have the right to have its claim declared nondischargeable even though Defendant's alleged misappropriation amounts to only a small fraction of that sum?"

I

In the Context of Section 17(a)(4) a Corporate Officer or Director Does Not Owe a Fiduciary Duty to the Corporation's General Creditors.

The Court of Appeals has concluded that

> "The responsibility of the individual defendants (petitioners herein) was then that of a fiduciary to plaintiff as a creditor of the corporation." Appendix A, *infra,* page ——. Said Court bases its fiduciary ruling on the cases of *Pepper* v. *Litton,* 308 U.S. 295, 306-307 (1939); *In re Petersen,* 25 F.Supp. 411 (E.D.N.Y. 1938); *Commons* v. *Schine,* 35 Cal. App. 3d 141, 110 Cal.Rptr. 606 (1973). However, a careful reading reveals that neither the *Pepper* case, nor the *Commons* case, involves the question of nondischargeability under the Bankruptcy Act. The *Peterson* case, which involved a $97.61 claim, and whose opinion covers less than a single page in the reporter, is not persuasive and should be disapproved to the extent it implies that a general creditor of a corporation

> has a direct and nondischargeable claim, equal to the amount of the creditor's claim against the corporation, against its officers for misappropriating corporate assets.

II

Any Nondischargeable Debt That Petitioners Incurred Is Owed Solely to Progressive or Its Trustee.

As liability in this case is predicated upon what petitioners did as officers and directors of Progressive, the cases hereinafter mentioned demonstrate that the nondischargeable debt is owed to the owner of the asset misappropriated. In this regard, it must be borne in mind that if anything was improperly taken in this case, it was not money or property that petitioners held in any fiduciary capacity for plaintiff, nor was it anything in which plaintiff had any ownership. The case of *U S. Fidelity & Guaranty Co.* v. *Tanner,* 279 F. Supp. 396 (D.C. Colo. 1968) is illustrative. This was a suit brought by the surety against an officer of the corporation who had "misappropriated" corporate property to his own use. The court was willing to assume that this was a misappropriation that would make the officer's debt *to the corporation* nondischargeable. Even though there was also a debt to the plaintiff-surety, that debt did not arise from the misappropriation and, therefore, the court held the debt to the plaintiff was discharged in bankruptcy.

Research by petitioners' counsel has failed to find any reported cases, with the possible exception of the *Petersen* case, *supra,* which adopt the "fraud in the air" approach as a ground for holding a creditor's individual claim against the corporation is also a nondischargeable claim against a controlling officer or di-

rector as a result of the latter misappropriating corporate property.

On the other hand, it is perfectly proper to deny a controlling officer or director a discharge on a given debt when he is sued by the corporation, its trustee or receiver. In this fashion, the misappropriated assets or the value thereof are recovered for the benefit of *all* the corporation's creditors. Cases supporting this rule are:

In Re Bernard, 87 F.2d 705 (2d Cir. 1937)

In Re Hammond, 98 F.2d 703 (2d Cir. 1968)

Kaufman v. *Lederfine,* 49 F.Supp. 144 (S.D.N.Y. 1943).

Likewise, where the "fraud, embezzlement, misappropriation or defalcation" is committed by the controlling officer *directly* against the creditor, the latter has a nondischargeable claim against such officer. For example, in the case of *John P. Maguire & Co.* v. *Herzog,* 421 F.2d 419 (5th Cir. 1970), an officer of the corporate debtor converted the creditor's security interest in the proceeds of certain merchandise collateral held under a flooring plan financing arrangement. Said arrangement required the debtor corporation to remit funds to the creditor upon a sale of the merchandise concerned. However, the officer of the debtor corporation improperly used such proceeds to prefer other creditors whose debts he had guaranteed. It was held that the creditor's claim against the officer was nondischargeable.

Finally, it is interesting to note that the well reasoned opinion of the Bankruptcy Judge below has already been adopted by another Bankruptcy Judge

in the case of *Robert Leal McReynolds, II, Bankrupt, Royal Cup, Incorporated, Plaintiff,* v. *Robert Leal McReynolds, II, Defendant,* Bankruptcy No. BK-3-75-820 (E.D. Tenn. 1976). Said decision was written by the Honorable Clive W. Bare. Prior to his personal bankruptcy, the Bankrupt was a controlling officer-director of a corporation that owed the plaintiff $20,262 for supplies. The Bankrupt also gave the creditor his personal note for the debt. Then the Bankrupt wrongfully withdrew $14,968 for his personal use when the corporation was insolvent. The creditor claimed its debt nondischargeable in the amount of $14,968.91. HELD: the debt of the creditor was discharged, inasmuch as the Bankrupt's wrongdoing only created a nondischargeable debt to the corporation.

III

There Is No Willful and Malicious Injury to the Property of Plaintiff.

It is submitted that the Court of Appeals holding, that Section 17(a)(8) of the Bankruptcy Act bars the petitioners' discharges of the plaintiff's debt, constitutes a tortured and illogical interpretation of that section. By any stretch of the imagination, how can it be said that misappropriating corporate assets by the controlling officers constitutes a "willful and malicious" injury to the unsecured debt owing to the plaintiff for tomato harvesting?

The Dissent of Judge Ely in Appendix A, *infra,* page ——, cannot be improved upon by this writer and it is hereby fully incorporated by reference.

CONCLUSION

Before this Court is the interpretation of Sections 17(a)(4) and 17(a)(8) of the Bankruptcy Act. This involves more than a struggle with statutory language. It involves the basic philosophy of what the sub-sections were designed to accomplish. There was never any misappropriation of property belonging to plaintiff, nor injury to property of plaintiff. Any claim that may exist by reason of petitioners misconduct, as officers and directors of Progressive, does not belong to plaintiff or any other individual creditor of said corporation.

It is imperative that this Honorable Court issue its Writ of Certiorari so that corporate officers and directors, and the lower courts, can have clearly settled these important federal questions.

Dated: March 3, 1980.

Respectfully submitted,

ALFRED CAMERON PAULDEN
ROBERT J. SELF

Attorneys for Petitioners,
Gary L. Foster, Gary L. Suthers,
and Donald Hoyt Hall, aka Don Hall

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 77-2664

LAWRENCE T. LASAGNA, INC.,
Plaintiff-Appellant,

v.

GARY L. FOSTER dba SNO-WHITE DRIVE-IN, INC.,
Defendant-Appellee.

LAWRENCE T. LASAGNA, INC.,
Plaintiff-Appellant,

v.

GARY L. SUTHERS,
Defendant-Appellee.

LAWRENCE T. LASAGNA, INC.,
Plaintiff-Appellant,

v.

DONALD HOYT HALL aka DON HALL,
Defendant-Appellee.

Appeal from the United States District Court for the Eastern District of California

OPINION
Filed December 7, 1979

Before: DUNIWAY and ELY, Circuit Judges, and PORT*, District Judge.

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* The Honorable Edmund Port, Senior United States District Judge for the Northern District of New York, sitting by designation.

PORT, District Judge:

Plaintiff Lawrence T. Lasagna, Inc. (Lasagna) filed identical complaints in the separate bankruptcy proceedings of Gary L. Foster, Gary L. Suthers and Donald Hoyt Hall (bankrupts) seeking a determination of the nondischargeability of bankrupts' indebtedness to Lasagna pursuant to Sections 17(a)(4) and 17(a)(8) of the Bankruptcy Act, 11 U.S.C. §§ 35(a)(4) and 35(a)(8).[1] The bankruptcy judge granted a motion to dismiss the amended complaint in each proceeding upon its face pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state a claim. The judgments were affirmed by the District Court for the Eastern District of California in a single judgment. We reverse and remand to the district court for further proceedings in each case.

THE COMPLAINT

The complaint alleges:

Lasagna on or about September 19, 1973 furnished machinery and equipment to Progressive Farming, Inc. (Progressive), a corporation wholly owned and controlled by the bankrupts and of which they were the sole officers and directors. As a result of the transaction Progressive became indebted to Lasagna in the sum of $24,365.17.

Lasagna sued Progressive and the bankrupts on this claim in Superior Court of the State of California, County

[1] Sections 35(a)(4) and 35(a)(8) provide:

> (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as . . . (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; . . . (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision.

11 U.S.C.A. § 35(a)(4), (8) (West Supp. 1979).

of Tulare. Summary judgment was granted in Lasagna's favor against Progressive; judgment was granted against bankrupts after a bench trial in the sum of $24,365.17 with interest and costs. It is this indebtedness of bankrupts that Lasagna's complaints seek to have determined nondischargeable. The state court found that the bankrupts' personal liability to Lasagna arose out of bankrupts' conduct of Progressive's business: Bankrupts (1) misappropriated funds of the corporation, (2) fraudulently transferred corporate property to themselves when Progressive was insolvent, by various means described in the findings, (3) violated their fiduciary obligations to Lasagna as officers and directors of Progressive, (4) caused Progressive to be further insolvent, and (5) unreasonably depleted its capital. As a result of the manner in which the affairs of the corporation were conducted, the state court disregarded the corporate entity and treated bankrupts as its alter ego.

The complaint alleged all the facts found by the state court judge. It alleged, in addition, other transfers to the bankrupts without consideration and in fraud of creditors. The findings, conclusions of law and judgment of the state court were attached to the complaint as exhibits and incorporated in it by reference.

DISCUSSION

Applicabiliy of § 35(a)(8):

The bankruptcy judge properly starts his analysis "by assuming [pursuant to a stipulation of the parties] the allegations in Plaintiff's complaint and said findings of fact [in the state court action] to be true." CR 54. The complaint alleges that the debt from the bankrupt to Lasagna, evidenced by the state court judgment, arose by reason of the willful and malicious injury to Lasagna's claim against Progressive, resulting from bankrupt's conduct. He then opines that section 17(a)(8), 11 U.S.C.

§ 35(a)(8), is inapplicable and requires no discussion. The district court affirmed the holding of inapplicability, basing its determination upon the ground that § 17(a)(8) requires an injury to specific "ear-marked" property of the creditor and that Lasagna's right to be paid by Progressive for goods sold to it would not constitute such property, a conclusion with which the dissent "thoroughly agree[s]." *See* p. —— *infra.*

The dissent says that "the congressional intent is plainly apparent on the face of the statute." The intent observed is "that the *character* of the interest alleged to have been injured . . . determine[s] dischargeability." *See* p. —— *infra* (emphasis added). Not only do we fail to discover such intent as "plainly apparent", but we find no evidence of such an intent. The plain language of the section is all inclusive with one exception not pertinent here. "[L]iabilities for willful and malicious injuries to the person or *property* of another" are declared nondischargeable. 11 U.S.C.A. § 35(a)(8) (West Supp. 1979) (emphasis added).

The dissent recognizes that the interest of Lasagna would be considered property if the debt from Progressive to Lasagna "had been secured by specified collateral whicl had been converted." This is a distinction without a difference. Property "denotes something subject to ownership, transfer or exclusive possession and enjoyment, which may be brought within the dominion and control of a court through some recognized process." *Gleason* v. *Thaw,* 236 U.S. 558, 561 (1915). The debt or account receivable from Progressive to Lasagna and the resultant judgment are specified property which can be sold, pledged or levied upon as readily as an automobile or any other property. Section 17(a)(8), 11 U.S.C. § 35(a)(8), is derived virtually without change from § 17(a)(2) of the Bankruptcy Act of 1898. There is nothing to indicate that "property" as used in this section was intended by Congress to have the lim-

ited meaning asserted by the dissent.[2] *See Tinker* v. *Colwell,* 193 U.S. 473 (1904); 1A W. Collier, Bankruptcy ¶ 17.17[1], at 1653 (14th ed. 1978). For instance, nothing in the Act indicates that liability resulting from a willful and malicious injury to an automobile is not dischargeable pursuant to § 35(a)(8), while liability resulting from similar conduct toward an account receivable or other indebtedness will be discharged. As this Court has indicated, dischargeability under § 35(a)(8) is determined by bankrupt's conduct rather than the character of the property injured:

> The statutory exception which measures non-dischargeability is ". . . for liabilities . . . for willful or malicious injuries to the person or property of another. . . ." The exception is measured by the nature of the act, *i.e.,* whether it was one which caused willful and malicious injuries. All liabilities resulting therefrom are non-dischargeable.

Coen v. *Zick,* 458 F.2d 326, 329 (9th Cir. 1972).

We recognize, as does our dissenting Brother that "exceptions to the operation of a discharge . . . should be confined to those plainly expressed." *Gleason* v. *Thaw,* 236 U.S. 558, 562 (1915) (legal services held not property within purview of provision "for obtaining property by false pretenses or false representations" under 1898 Bankruptcy Act as amended in 1903).[3] What we said in *Paton*

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[2] Nowhere in the legislative reports or debates is there any restriction placed upon the kind of property within the purview of the section.

[3] It is interesting to note that § 523(a)(2)(A) of the new Bankruptcy Code, 11 U.S.C. § 523(a)(2)(A) (enacted under Pub. L. No. 95-598, § 101, 92 Stat. 2590 (1978)), effective October 1, 1979, specifically includes "services." "The effect of this is to overrule cases under the Bankruptcy Act that excluded from the concept of property services of all kinds, whether they be professional or otherwise." 3 W. Collier, Bankruptcy ¶ 523.08, at 523-34 (15th ed. 1979).

v. *England*, 462 F.2d 1099, 1100 (9th Cir. 1972), is apt here:

> However, be that as it may, the Court, over the years, has frequently pointed out that the Congressional solicitude is limited to, and the prophylactic benefit of a discharge is exclusively reserved for, "the honest and unfortunate debtor . . ." the purpose being to afford him "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of a pre-existing debt." Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 699, 78 L.Ed. 1230 (1934). There can be no doubt of the power of Congress to discriminate between the worthy and the unworthy debtor with respect to the matter of discharge. Hanover Nat. Bank v. Moyses, 186 U.S. 181, 192, 22 S.Ct. 857, 46 L.Ed. 1113 (1902).

The Congress early recognized the distinction between the ordinary indebtedness and the wrongfully incurred indebtedness and between the honest and dishonest debtor. This distinction is recorded in many instances during the congressional debates on the Bankruptcy Act of 1898. For instance:

> A discharge will be granted unless it shall be made to appear, speaking in general terms, that the defendant has been guilty of some act of dishonesty or has been guilty of the perpetration of frauds with reference to his property.
>
> Although a discharge in bankruptcy may be granted, still it will not operate as against taxes or judgments which have been rendered in actions for the commission of frauds or the willful or malicious injury to persons or property, . . . or such claims as were created by his wrongdoing while acting as an officer or in a fiduciary capacity.

31 Cong. Rec. 1786 (1898); *see also id.* at 1784, 1785, 1788, 1790, 1795, 1796, 1797-98.

Applicability of § 35(a)(4):

The bankruptcy court found § 35(a)(4) inapplicable because (1) the debt to Lasagna was not created by fraud or misappropriation but arose out of the machinery transaction with Progressive, and (2) no fiduciary relationship existed between Lasagna and bankrupts. This misconceives the nature of the debt or obligation: "To determine the character of the liability upon which the appellant's judgment was founded, we must look to the suit in which it was rendered." *In re Hammond,* 98 F.2d 703, 704 (2d Cir.) (citing *In re Harber,* 9 F.2d 551 (2d Cir. 1925)), *cert. denied,* 305 U.S. 646 (1938). *See Terzian* v. *California Casualty Indemnity Exchange,* 42 Cal. App. 3d 942, 946, 117 Cal. Rptr. 284, 287 (1974).

Although initially an indebtedness was created from Progressive to Lasagna, if the facts alleged are proven, the fraudulent conduct of the affairs of Progressive by bankrupts as officers and directors of Progressive having a fiduciary responsibility to the creditors of Progressive gave rise to an obligation and created an indebtedness to Lasagna resulting in the Superior Court judgment. But for the bankrupts' fraudulent conduct, there would have been no debt due from bankrupts; Progressive would be the only debtor. *In re Metz,* 6 F.2d 962 (2d Cir. 1925); *Ivy* v. *Plyler,* 246 Cal. App. 2d 678, 54 Cal. Rptr. 894 (1966) (judgment rendered against bankrupt officer of insolvent corporation under doctrine of *alter ego* held nondischargeable); *In re Petersen,* 25 F. Supp. 411 (E.D.N.Y. 1938); *John P. Maguire & Co., Inc.* v. *Herzog,* 421 F.2d 419 (5th Cir. 1970); *In re Bernard,* 87 F.2d 705 (2d Cir. 1937).

Both the bankruptcy judge and the district judge placed some emphasis upon the fact that in the state court action,

that court concluded that the three bankrupts were the alter ego of Progressive. The notion seems to be that this made them liable on the original indebtedness of Progressive as part of a single fictitious unit composed of Progressive and the three individual bankrupts. The phrase "alter ego" will not bear such a load. It is a convenient bit of shorthand for various types of cases in which officers or directors or stockholders or all three are held to be liable for the obligations of their corporation. The reality, however, is as we have stated. The bankrupts were not originally liable on Progressive's debt. Their conduct, as described in the complaints and as found by the state court, created a new liability on their part directly to Lasagna.

The short answer to the lack of fiduciary relationship is finding of fact No. 8 in the state court action, made part of the complaint, that "the responsibility of the individual defendants [bankrupts] was then that of a fiduciary to Plaintiff as a creditor of the corporation." CR 11. *See generally Pepper* v. *Litton,* 308 U.S. 295, 306-307 (1939); *In re Petersen,* 25 F. Supp. 411 (E.D.N.Y. 1938); *Commons* v. *Schine,* 35 Cal. App. 3d 141, 110 Cal. Rptr. 606 (1973).

Appellee's contention that Lasagna lacks standing to bring the present proceeding can be dismissed summarily by reference to 11 U.S.C. § 35(c)(1): "The bankrupt or any creditor may file an application with the court for the determination of the dischargeability of any debt."

Appellee's contention that the holding in *United States Fidelity and Guaranty Co.* v. *Tanner,* 279 F. Supp. 396 (D. Colo. 1968) supports a suit by Progressive but bars suit by Lasagna does not hold up under examination. There, the court merely found that the plaintiff surety company could not exclude its claim from Tanner's discharge in bankruptcy under the willful and malicious conversion provision because it failed to sustain its burden of proof. It further found:

> [T]he debt owed by Tanner to the Plaintiff did not arise as a result of a breach of any fiduciary duty as an officer or otherwise owed by Tanner to the Plaintiff.
>
> The debt here in question *arose by virtue of an indemnity agreement executed by Tanner in his individual capacity* to indemnify Plaintiff from any loss it might suffer on Bonds issued to the United States by Tanner, Inc. as principal and the Plaintiff as surety.

279 F. Supp. at 400 (emphasis added). There was no need for the court to reach the question raised by appellee.

Effect of the State Court Judgment:

The judgment of the state court is not conclusive. As we said in *In re Houtman,* 568 F.2d 651 (9th Cir. 1978), after the 1970 Amendments, the doctrine of collateral estoppel may not be applied in determining dischargeability of debt evidenced by state court judgments under § 17 of the Act. The state court judgment establishes a prima facie case of a debt nondischargeable in bankruptcy. However, the bankrupt is entitled to refute that prima facie case. The bankruptcy court may consider all relevant evidence, including (but not limited to) state court proceedings, offered by the parties and requested by the court, and on the basis of the evidence determine dischargeability of the debt. We apply "the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief", *Conley* v. *Gibson,* 355 U.S. 41, 45-46 (1957) (footnote omitted).

The judgment of the district court affirming the bankruptcy judge is reversed, and the case is remanded to the district court for further proceedings in accordance with this opinion.

ELY, Circuit Judge (concurring in part and dissenting in part):

I concur only in that portion of my Brother's Opinion which holds that the two lower courts erred in determining that Section 17(a)(4) of the Bankruptcy Act [1] was inapplicable under the facts as alleged by the judgment creditor, Lawrence T. Lasagna, Inc. ("Lasagna"). From the conclusion that Section 17(a)(8)[2] is applicable, however, I respectfully dissent.

In its original action in state court, Lasagna sought to recover from Progressive Farming, Inc. ("Progressive") and the three bankrupt appellees for tomato harvesting services rendered to Progressive by Lasagna. The state court awarded Lasagna an as yet unsatisfied judgment of $24,365.17, with interest and costs, against the three appellees, the sole shareholders of Progressive at the time the corporation became indebted to Lasagna. The appellees were held liable under the *alter ego* theory for the corporate debt of Progressive and on the basis of having made fraudulent conveyance to themselves which rendered Progressive unable to pay its debt to Lasagna. An examination of the pleadings in the Bankruptcy Court and of the state court judgment makes clear that it was this looting by fraudulent conveyance which gave rise to the liability of the appellees to Lasagna. It is for this reason that I believe that the majority is right in holding that Lasagna alleged adequate facts to support a claim under Section 17(a)(4), the debt assertedly having been ". . . created by . . . fraud, embezzlement, misappropriation or defalcation while acting as . . . officer[s] or in any fiduciary capacity . . . ." 11 U.S.C. § 35(a)(4).

I disagree, however, with my Brothers in the resolution of the issue concerning the applicability of Section 17(a)(8).

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[1] 11 U.S.C. § 35(a)(4).

[2] 11 U.S.C. § 35(a)(8).

The basis for that disagreement is Lasagna's failure to identify any "property," within the meaning of the Section, that could have been willfully and maliciously injured by the appellees. The majority seems to assume that the injured "property" was the unsecured debt owing to Lasagna for the tomato harvesting, the debt never paid because of Progressive's insolvency. Because that insolvency was assertedly caused by appellees' defalcations, the majority concludes that Section 17(a)(8) would, if the facts are as alleged by Lasagna, bar discharge of the state court judgment.

The District Court upheld the Bankruptcy Court's determination that Section 17(a)(8) was inapplicable because "[n]o injury has been done to any 'earmarked' property of the plaintiff-appellant [Lasagna] . . . ." C.R. 72. With this conclusion, I thoroughly agree.

As I see it, the congressional intent is plainly apparent on the face of the statute. That intent was that the character of the interest alleged to have been injured should in fact determine dischargeability. It is only injuries to "property" that are not dischargeable. I recognize that the term "property" is so broad that it is not always capable of fixed interpretation.[3] But, because the operation of a dis-

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[3] Grappling with just such an attempt to define "property," the Supreme Court wrote:

> The accurate delimitation of the concept property would afford a theme especially apposite for amplificative philosophic disquisition; but the Bankrupt Law is a prosy thing intended for ready application to the everyday affairs of practical business, and when construing its terms we are constrained by their usual acceptation in that field of endeavor.
>
> • • • •
>
> At most it [property] denotes something subject to ownership, transfer or exclusive possession and enjoyment, which may be brought within the dominion and control of a court through some recognized process. This is certainly the full

charge under the Bankruptcy Act "should be confined to those plainly expressed . . ." (*Gleason* v. *Thaw,* 236 U.S. 558, 562 (1915)), I cannot join my Brothers in expanding the reach of Section 17(a)(8) beyond what I perceive to be its permissible limits. No decisions of our court, or any other,[4] support the result reached by the majority, especially not *Tinker* v. *Colwell,* 193 U.S. 473 (1904), a decision upon which the majority relies for the proposition that Section 17(a)(8) includes within its purview the debt owed by appellees to Lasagna.

In *Tinker,* the Supreme Court recognized that, in 1904, the law protected a husband's personal and exclusive rights in his wife with which there could be legal interference by another man's criminal conversation with the

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extent of the word's meaning as employed in ordinary speech and business and the same significance attaches to it in many carefully prepared writings.

Gleason v. Thaw, 236 U.S. 558, 560-61 (1915).

[4] My research has uncovered no cases that have given Section 17(a)(8) protection to such an undifferentiated expectancy as has the majority here. To the contrary, in those cases dealing with the dischargeability of debts arising out of a bankrupt's "willful and malicious" interference with a creditor's ability to collect on his account, Section 17 "property" has been recognized to have been injured only in more limited contents such, for example, as when the interference has been directed at security interests in real property, personalty, or accounts receivable. *See, e.g.*, McIntyre v. Kavanaugh, 242 U.S. 138 (1916) (corporate stock held as security for indebtedness); In re Nance, 556 F.2d 602 (1st Cir. 1977) (assignment of deferred wages); Baker v. Bryant Fertilizer Co., 271 F. 473 (4th Cir. 1921) (accounts assigned as security); Sommerfield v. Klinkowitz, 245 Wis. 619, 15 N.W.2d 850 (1944) (mortgaged property held as security); Probst v. Jones, 262 Mich. 678, 247 N.W. 779 (1933) (mortgaged property); Excel Finance Camp, Inc. v. Tannerhill, 140 S.2d 202 (La. Ct. of App. 1962) (mortgaged property held as security on indebtedness); Wheaton v. Chandler, 68 Ohio App. 474, 42 N.E.2d 193 (1941) (attorney's retaining lien); *see also* In re Blauweiss, 23 N.Y.S. 2d 907 (City Ct. 1940) (conversion of emerald).

wife. *Id.* at 481. Such rights, by their very nature, were, of course, intangible. Yet, intangible though they were, the husband's rights were *identifiable* and *exclusive* to him. In recognizing that these legally protectible interests were of the kind that fell within Section 17,[5] the Supreme Court wrote:

> [T]he husband has certain *personal and exclusive rights* with regard to the person of his wife which are interfered with and invaded by criminal conversation with her; . . . that an assault of this nature may properly be described as *an injury to the personal rights and property of the husband,* which is both malicious and willful.

Id. at 481 (emphasis added).

And:

> [T]he cause of action by the husband is based upon the idea that the act of the defendant is a violation of the marital rights of the husband in the person of his wife, *to the exclusion of all others,* and so *the act of the defendant is an injury to the person and also to the property of the husband.*

Id. at 485 (emphasis added).

Here, Lasagna held no personal or property rights in Progressive "to the exclusion of all others." A best, Lasagna had an expectancy that it would be paid from the general assets of Progressive, a right deserving no greater

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[5] Tinker v. Colwell, 193 U.S. 473 (1904), was decided under the Bankruptcy Act of 1898, ch. 541, § 17, 30 Stat. 550 (1898). The exception to discharge in question here was then contained in Section 17(a)(2), which then, in relevant part, read:

> (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (2) are liabilities . . . for willful and malicious injuries to the person or property of another . . . .

protection under Section 17(a)(8) than that afforded to any other unsecured creditor. Moreover, there is no allegation in the record that appellees directed any of their activities directly at this generalized expectancy of Lasagna. Rather, the breach of duty by appellees, as found by the state court, was directed at Progressive, an entity in which Lasagna held no legally protectible interest that differed from that held by other general creditors.

The majority's view would be correct if the debt had been secured by specified collateral which had been converted by appellees. *See, e.g., McIntyre* v. *Kavanaugh,* 242 U.S. 138 (1916); *In re Nance,* 556 F.2d 602 (1st Cir. 1977); *Probst* v. *Jones,* 262 Mich. 678, 247 N.W. 779 (1933). Then, clearly, we could in good conscience write that appellees had deliberately injured "property" of the appellant. *See First National Bank of Lansing* v. *Padjen,* 61 Ill. App. 2d 310, 210 N.E.2d 332, 334 (1965) ("That the mortgagee's interest in the chattel securing a loan is a protectible property cannot be doubted."). Here, however, there was no willful damage to any "property" of Lasagna; therefore, I am convinced that the lower courts were absolutely correct in holding that Section 17(a)(8) is not applicable. My conviction as to this is fortified when I compare Section 17(a)(8) to Section 17(a)(4), which clearly is applicable. Congress has provided one exception to discharge under the facts as alleged by Lasagna. To interpret Section 17 (a)(8) as the majority has done not only is unnecessary, but also, I submit, expands the Section's meaning beyond all logical reason. I cannot conceive that the Congress, when enacting the Secton, intended that its enactment should ever be given such an expansive interpretation.

As to the issue involving Section 17(a)(8), I would therefore affirm the judgment of the District Court.

/s/ Wilbur Ely
United States Circuit Judge

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

No. F-75-1562 Bky

Lawrence T. Lasagna, Inc.,
Plaintiff and Appellant,
v.
Gary L. Foster, dba Sno-White Drive-In, Inc.,
Defendant and Respondent.

No. F-76-581 Bky

Lawrence T. Lasagna, Inc.,
Plaintiff and Appellant,
v.
Gary L. Suthers,
Defendant and Respondent.

No. F-76-148 Bky

Lawrence T. Lasagna, Inc.,
Plaintiff and Appellant,
v.
Donald Hoyt Hall, aka Don Hall,
Defendant and Respondent.

ORDER ON APPEAL FROM OPINION OF THE BANKRUPTCY JUDGE DATED JUNE 23, 1976

Filed November 3, 1976

The appeal from the opinion of the Bankruptcy Judge, dated June 23, 1976, granting defendant's motion to dismiss, was heard on October 26, 1976, plaintiff Lawrence T. Lasagna, Inc., being represented by Fred H. Dill, Esq.,

and defendants Gary L. Foster, dba Sno-White Drive-In, Inc., Donald Hoyt Hall, aka Don Hall, and Gary L. Suthers, being represented by Robert J. Self, Esq., and the matter was taken under submission.

Section 17(a)(8) of the Bankruptcy Act has no application to the facts of this case. No injury has been done to any "earmarked" property of the plaintiff-appellant. Notwithstanding the fact that all three bankrupts were subsequently held personally liable for the services rendered by the plaintiff-appellant, this liability was not attached to any specific property owned by the Progressive Corporation. See, *First National Bank of Burr Oak* v. *Seamon* (1972), 198 N.W.2d 114.

Nor is Section 17(a)(4) of the Bankruptcy Act applicable to make the defendant-appellees' debts nondischargeable. The reasons for this are threefold, to wit:

1. The debts herein created were not "created" by the appellees' fraud, embezzlement, misappropriation or defalcation. The conduct of the bankrupts did not create the debt, rather their fraudulent conduct merely made them personally liable for a debt previously incurred by the Progressive Corporation.

2. No fiduciary duty existed between plaintiff-appellant and the bankrupts. It is well established that the words "fiduciary capacity" relate to a person who is in the position of a trustee by virtue of technical or express trusts. The debtor must have been a fiduciary when the debt was created and he must be such a fiduciary irrespective of the debt or the circumstances giving rise to it. It is insufficient that a situation arises in the course of a relationship which by reason of the intervention of principles of equity generates a position of confidence and wrong done by reason of faithlessness thereto. See, *Frank Sheridan Jonas, Inc.* v. *Romanat* (1955) 144 NYS 2d 248.

3. The case law establishes that only the corporation (Progressive herein) through a trustee in bankruptcy has the right under the facts of this case to employ Section 17(a)(4). See, *Frank Sheridan Jonas, Inc.*, supra, and *United States Fidelity and Guaranty Company* v. *Tanner* (1968) 279 F.Supp. 396.

Therefore, the opinion of the Bankruptcy Judge is affirmed and his findings of fact and conclusions of law are adopted.

DATED: November 3, 1976.

/s/ M. D. CROCKER
United States District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

No. F-75-1562-Bky In Bankruptcy

In the Matter of

GARY L. FOSTER
dba Sno-White Drive-In, Inc.,
Bankrupt.

LAWRENCE T. LASAGNA, INC.,
Plaintiff,

v.

GARY L. FOSTER,
Defendant.

OPINION

Filed June 23, 1976

Plaintiff seeks to have the debt of the Defendant, Bankrupt, declared nondischargeable under sections 17(a)4 and 17(a)8 of the Bankruptcy Act. Plaintiff's complaint alleges that on or about September 19, 1973, a corporation known as Progressive Farming, Inc., became indebted to it in the sum of $24,365.17 for equipment rental; that at said time and thereafter Defendant owned 40% of the stock in Progressive Farming, Inc. On September 24, 1975, the Superior Court in Tulare County rendered a judgment in favor of Plaintiff and against Defendant holding Defendant liable for said corporate debt on the alter ego theory. Plaintiff contends said judgment is res judicata in this proceeding and that by virtue thereof this court should render a judgment determining said debt to be nondischargeable under sections 17(a)4 and 17(a)8 of the Bankruptcy Act. Plaintiff's complaint and the findings of fact, conclusions of law and judgment in that case as set forth in Plaintiff's complaint are incorporated herein by reference. The principal assertions of said complaint and said findings are that Defendant was guilty of fraud and of misappropriating property of said corporation of which he was an officer and major stockholder.

This is a hearing on Defendant's motion to dismiss Plaintiff's complaint on the ground it fails to state a claim against Defendant on which relief can be granted. By stipulation in open court this court has been asked to decide whether, assuming the allegations in Plaintiff's complaint and said findings of fact to be true, Plaintiff would be entitled to a judgment determining the debt to be nondischargeable.

The court is of the opinion that section 17(a)8 has no application to the facts of this case and will confine its discussion as to the applicability of section 17(a)4.

Section 17(a)4 states that a discharge in bankruptcy shall not release or affect debts which "were *created* by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." There is no assertion in said findings or in Plaintiff's complaint that the debt from Progressive Farming, Inc. to Plaintiff was *"created"* by fraud. All of the conduct complained of occurred after the creation of the debt; the conduct of Defendant did not create the debt, it merely made him liable for a debt previously incurred by the corporation. It would therefore seem that the debt would be dischargeable under section 17(a)4.

The only case cited by Plaintiff which would hold Defendant's liability on the alter ego theory nondischargeable is Ivy v. Plyler 246 Cal App 2d 678; this case ignores the precise wording of section 17(a)4 which limits nondischargeability to debts *"created"* by fraud, etc.; it also

ignores the fact that if there had been no corporation in the first place and had Defendant directly incurred the indebtedness to Plaintiff, the debt would clearly be dischargeable—the Defendant then would not have been holding any property in a fiduciary capacity and Defendant could have dissipated his assets in drinking, gambling, or in any manner he saw fit and the debt would still have been dischargeable. The court erred when it destroyed the corporation to create the liability and then used it to find the debt nondischargeable. It should also be noted that the cases cited by the court in the Ivy case as cases in which "defalcation" and "misappropriation" occurred are not cases in which the alter ego doctrine is applicable.

As stated in Cowans, *Bankruptcy Law and Practice #472* at page 280,

> ". . . The person seeking to except a debt must be the person to whom the fiduciary duty was owed or the organization of which the bankrupt was an officer."

As authority for this statement Cowans cites U.S. Fidelity and Guarantee Co. v. Tanner 279 Fed Supp 396 DC Colo. 1969. (sic)

To hold Defendant's liability nondischargeable on the alter ego theory in this case or in any similar case could lead to an absurd result. For example, suppose Defendant's misappropriation in a given case is in the total sum of $10,000.00 and he owes 100 creditors $10,000.00 each? Should each of said 100 creditors have the right to have his debt declared nondischargeable so that Defendant would be subjected to a nondischargeable liability in the sum of $1,000,000.00? In the case at bar, Defendant's schedules list unsecured creditors in the amount of $2,487,866.56 (including contingent claims); should each of these creditors have the right to have its claim declared nondischargeable even though Defendant's alleged misappropriation amounts to only a small fraction of that sum? Where the liability

of Defendant, as in this case, is predicated upon what the Defendant did as an officer or director of the corporation, the following cases demonstrate that nondischargeable debts are limited in amount by what has been appropriated and that the nondischargeable debt is to the owner of that money. (It must be borne in mind that if anything was improperly taken in this case it was not monies or property that Defendant held in any fiduciary capacity nor was it anything in which Defendant had an ownership.) See:

> In re Bernard 87 F 2d 705 (2d Circ. 1937)
>
> In re Hammond 98 F 2d 703 (2d Circ. 1938)
>
> Kaufman v. Lederfine 49 F Supp. 144 (1943 So. Dis. of N.Y.)
>
> John P. Maguire and Co. v. Herzog 421 F 2d 419 (5th Circ. 1970) (sic).

Plaintiff in its closing brief states at page 2, lines 16 to 25,

> ". . . the asserted liability is based not on the alter ego theory alone but upon the further theory that there was a fraudulent conveyance of corporation assets under the Uniform Fraudulent Conveyances Act as enacted in California, and that there is liability for that fraudulent conveyance on the part of the Defendants in their dual capacity as transferor *and transferee*. The specific issue which Professor Laube failed to respond to is whether a transferor or transferee under circumstances falling within the definition of a fraudulent conveyance under state law can obtain a discharge under the Bankruptcy Act."

This argument might be pertinent to an objection to a general discharge under section 14, but is not pertinent to the objection to dischargeability filed by Plaintiff under section 17(a).

It is therefore the opinion of the court that even assuming the allegations in Plaintiff's complaint to be true and that the Judgment of the Superior Court on which Plaintiff relies is res judicata, Plaintiff's complaint does not state a claim against Defendant on which relief can be granted and that Defendant's motion to dismiss should be granted.

This opinion may serve as the Findings of Fact and Conclusions of Law. Counsel for Defendant is directed to prepare, serve and forward an order based thereon.

The clerk of this court is directed to serve copies of this opinion by U.S. mail upon the attorneys for the parties appearing in this cause.

DATED: June 23, 1976.

/s/ ECKHART A. THOMPSON
Eckhart A. Thompson
Bankruptcy Judge

APPENDIX D

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Attorneys for Claimant
Lawrence T. Lasagna, Inc.

UNITED STATES DISTRICT COURT OF CALIFORNIA
EASTERN DISTRICT

No. F-76-581-BKY

In the Matter of

GARY L. SUTHERS, *Bankrupt.*

COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

LAWRENCE T. LASAGNA, INC., a California corporation, a creditor of the above-entitled Bankrupt, having a provable claim against said Bankrupt, hereby opposes the granting to the Bankrupt of a discharge from his debt to Claimant upon the following grounds:

I

That on September 24, 1975, in an action entitled LAWRENCE T. LASAGNA, INC., vs. PROGRESSIVE FARMING, INC., et al., being Action No. 76375 of the Superior Court of the State of California, for the County of Tulare, judgment was entered by said Court, the Honorable Leonard M. Ginsburg, Judge Presiding, in favor of Plaintiff and against the Bankrupt GARY L. SUTHERS in the amount of $24,365.17 together with interest thereon at the legal rate from September 19, 1973, together with $414.90 costs. A copy of said judgment and findings of fact are attached

hereto marked Exhibit "A" and Exhibit "B" respectively, and incorporated herein by reference. Said judgment is now due and payable and remains unsatisfied.

II

That the acts of the Bankrupt on which the State Court judgment and the claim of Claimant herein are based were as follows:

(a) On or about September 19, 1973, Claimant performed services for a corporation known as Progressive Farming, Inc. whereby Claimant furnished the necessary machinery and equipment to harvest certain tomatoes and said Progressive Farming, Inc. became indebted to Plaintiff on account thereof in the sum of $24,365.17.

(b) That at the time Progressive Farming, Inc. became indebted to Claimant as aforesaid and at all times thereafter the Bankrupt was the owner of 40% of the stock of said Progressive Farming, Inc. and was an officer and director of said Corporation. That the only shareholders, officers and directors of said Progressive Farming, Inc. were the Bankrupt and his co-defendants in the State Court action, DONALD H. HALL and GARY L. FOSTER.

(c) That from the date of its incorporation prior to September 19, 1973, and at all times thereafter said Progressive Farming, Inc. was without adequate capital to carry on its business affairs and was wholly undercapitalized.

(d) That the Bankrupt caused the funds of Progressive Farming, Inc. to be co-mingled with his own funds and with the funds with other entities with which the Bankrupt was affiliated or owned an interest.

(e) That the Bankrupt caused Progressive Farming, Inc. to make loans and advances to the Bankrupt without adequate security and with no intention or (*sic.*) repayment.

(f) That the Bankrupt caused Progressive Farming, Inc. to fail to maintain adequate records and confuse the corporate records of Progressive Farming, Inc. with those records of other entities as to which the Bankrupt had interest.

(g) That the Bankrupt participated in the management of Progressive Farming, Inc. at a time when the management of said Progressive Farming, Inc. was identical with the management of other business entities as to which Bankrupt owned an interest.

(h) That the Bankrupt caused Progressive Farming, Inc. to disregard legal formalities in the conduct of its business affairs with the Bankrupt and with the others.

(i) That the Bankrupt caused assets of Progressive Farming, Inc. to be diverted from Progressive Farming, Inc. to himself without any consideration therefor.

(j) That the Bankrupt as an officer and employee of Progressive Farming, Inc. drew an inordinately large salary and advances from Progressive Farming, Inc. in light of the true and actual financial condition of said Progressive Farming, Inc.

(k) That at the time the debt due Claimant from Progressive Farming, Inc. was incurred there was such a unity of interest in the ownership of said Progressive Farming, Inc. that the individuality and the separateness of the Bankrupt and the said Progressive Farming, Inc. had ceased and adherence to the fiction of the separate existance (*sic.*) of said Progressive Farming, Inc. and that of the Bankrupt was such that to prevent a fraud and to protect the rights of Claimant and to accomplish justice that the distinct existence of Progressive Farming, Inc. and its shareholders if properly disregarded and that the interest and identity of the Bankrupt and Progressive Farming, Inc. are and were identical. That at the time Progressive

Farming, Inc. became indebted to Claimant as aforesaid, Progressive Farming, Inc. was the alter ego of Bankrupt.

(1) That on and after September 19, 1973, Progressive Farming, Inc. (the alter ego of the Bankrupt) was "insolvent" in that the then present fair saleable value of the assets of said Progressive Farming, Inc. was less than the amount that was then required to pay its probable liabilities on its existing debts as they became absolute and matured.

(m) That on or about May 1, 1973, the Bankrupt as an officer and director of Progressive Farming, Inc. entered into an agreement upon behalf of Progressive Farming, Inc. whereby Progressive Farming, Inc. agreed to purchase for the sum of $80,000.00 certain corporate shares in a firm known as Southern Tulare Farming, Inc. That thereafter the Bankrupt caused Progressive to pay from its funds to the seller of the corporate shares the sum of $40,000.00. That the Bankrupt thereafter and without consideration transferred the interest of Progressive Farming, Inc. in said agreement to purchase said shares from Progressive Farming, Inc. to the Bankrupt and did in fact complete the purchase of said shares for the Bankrupt's own account. That on or about October 16, 1973, the Bankrupt without an adequate consideration and while acting as an officer and director of Progressive Farming, Inc. caused Progressive Farming, Inc. to transfer certain additional shares in the corporation known as Southern Tulare Farming, Inc. (such shares representing a fifty per cent ownership in Southern Tulare Farming, Inc. and having been owned by Progressive Farming, Inc. prior to May 14, 1973) to the Bankrupt and the Bankrupt's business associates as individuals. That the then fair market value of Southern Tulare Farming, Inc. shares which the Bankrupt transferred without consideration was in excess of the sum of $32,000.00.

(n) That during the years of 1973 and 1974 during which times the Bankrupt was at all times an officer and director of Progressive Farming, Inc., the Bankrupt caused Progressive Farming, Inc. to pay to the Bankrupt an inordinately large salary in light of the services furnished and the actual financial condition of said Progressive Farming, Inc.

(o) That at the time of transfer the said transfers were made by the Bankrupt with the intent to hinder, delay and defraud creditors of Progressive Farming, Inc.

(p) That the effect of the transfers was to render Progressive Farming, Inc. with unreasonably small capital remaining to carry on its business affairs.

(q) That the transfers and acts by the Bankrupt as aforesaid constituted a fraudulent conveyance of the property of Progressive Farming, Inc. as described in California Civil Code Sections 3439.04, 3439.05 and 3439.07.

III

That the said judgment of the State Court is a debt such as is described in Section 17 (a) (4) and (8) of the Bankruptcy Act (11 U.S.C. Section 35).

IV

That no part of said judgment has been paid, that enforcement of said judgment has not been stayed and that execution may properly issue thereon.

• • • • • • • • • •

WHEREFORE, Claimant prays:

1. That an order be made denying to the Bankrupt discharge as to this debt and judgment.

2. Such other and further relief as the Court may deem just.

LAWRENCE T. LASAGNA, INC.
Claimant

/s/ By LAWRENCE T. LASAGNA, PRES.

DILL AND SHOWLER

/s/ By FRED H. DILL
Attorneys for Claimant

APPENDIX E

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—

• • •

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny

• • •

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;